RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

Jan. 28, 1987 **LETTER 957**

Jan. 16 DJIA 2076.63; PTI 2496; A-D Ratio -5.29
Jan. 23 DJIA 2101.52; PTI 2505; A-D Ratio -5.16

THE MARKET: During the first week in January we saw the force of a powerful bull market thrust the Dow over the 2000 mark. To put it mildly, that dramatic move got everyone's attention. I don't think there's a newspaper in the nation that failed to write up the "Dow over 2000" story.

As a bull market progresses and gathers steam, it likes to beckon to the public. The bull knows what Madison Avenue knows, and that is that "it pays to advertise." And as far as financial ads go, there's no advertisement that can possibly equal the excitement of the D-J Industrial Average hurdling a major even number like 500 or 1000 or 2000.

That's the bull's way of making himself known. It's comparable to the New York Giants smashing the San Francisco 49ers for a score of 49 to 3 (which they did) or a prize fighter like Mike Tyson battering out an opponent in the second round and becoming the heavyweight champion (which is what he did). Yes, Wall Street's January performance was a whopper -- it was like a huge, flashing neon sign advertising "bull market." And, of course, heavily committed investors across the nation love it (and when I say that I assume that I am talking about the majority of my subscribers).

So ornery cuss that I am, what am I doing? I'm writing (in this Letter) a big section about what the next bear market will look like -- and why I continue to advocate a program of buying gold. I'm writing this section because I think stocks are getting expensive now, because I think gold is still cheap in this area, and because as this bull market works itself higher, I'm going to force myself and my subscribers to become increasingly cautious.

Yes, the louder the voice of the bull, the more the excitement, the bigger the volume, the higher the markets, the more I'll be tempted to say, "Let's cool it a bit." I won't turn bearish, mind you (keep your eye on my PTI on the page 2 chart), but I'll be growing more skittish, more edgy. It's just a normal reaction on my part. I've been around markets too long to act otherwise.

All right, let's turn to the market action. On January 14 the Value Line and the AMEX finally rallied to new record highs, and on January 16 the D-J Transportation Average finally confirmed the Industrial Average by climbing to a new record high. Thus, under Dow Theory the primary trend is again re-confirmed as bullish. On January 19 as the Dow leapt over the 2100 mark: all three D-J Averages (Industrials, Transports, Utilities) recorded new highs together. That's a rare sight, and that's impressive action!

What about breadth? You remember that the A-D ratio has been the lagging indicator ever since last April. In fact, lagging breadth was the divergent item on which most of the pessimists built their bearish cases. So what did the bull market do? On January 14 the A-D ratio (see page 2 chart) broke above all its peaks going back to April 21. That move left the A-D just one-third of a point from its April 21 bull market high.

QUESTION: This has been a great January, one of the best in history. In view of this, what do you think of the widely-watched "January barometer" and what do you think it is telling us now?

ANSWER: I don't think the January barometer is telling us a darn thing. I avoid formulas and automatic gimmicks of all kinds when dealing with the stock market, and I don't care if you're talking about the Super Bowl, women's skirt lengths or the January barometer. When dealing with formulas, it's those little exceptions that kill you.

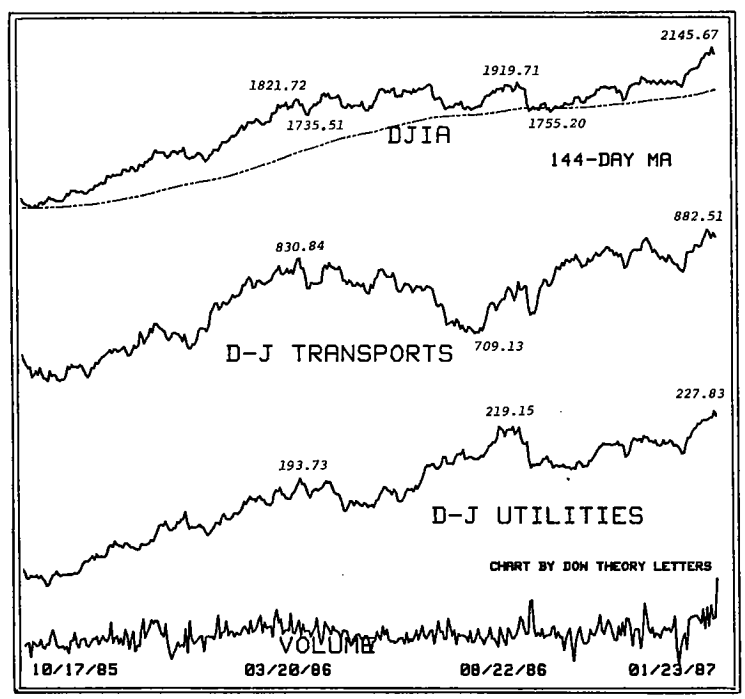
Here's some information that not one out of a thousand analysts knows. The year 1928 ended with the Dow at 300.00 (Dec. 31, 1928). On January 31, 1929, the Dow closed at 317.51 -- up 5.8% for the month of January. The January barometer was saying that 1929 was to be a good year. Again, the year 1929 ended with the Dow at 248.48. By the end of January 1930 the Dow was at 267.14, up 7.5% for the month of January. Yet 1930 was a disaster (the Dow was down 33.7% for the year). By the way, the same thing happened in 1937: the market was up in January, but later in the year the market crashed horribly.

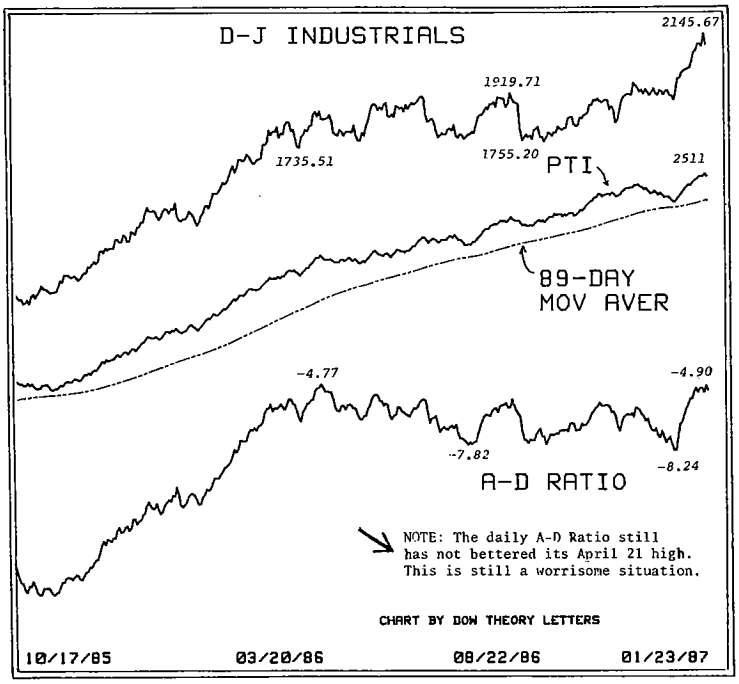
Conclusion: Forget January, the real criterion is whether the primary trend of the market is bullish or bearish (the primary trend turned bearish in September 1929 and it was bearish all during 1930).

QUESTION: Russell, what do you think of the now commonplace predictions of "Dow 3000" and "Dow 3500"?

ANSWER: To tell the truth, those predictions bother me; they're too widely advertised and too widely accepted.

It is ironic, but today everyone (and maybe the current popularity of technical analysis is responsible for this) is talking about market action: the number of days the Dow has advanced, confirmations, new highs, advance-decline figures, volume indications, short interest. The daily newspapers are bulging with technical statistics (recently, the WSJ and Barron's have even revised their market statistics pages). BUT ALMOST NO ONE IS TALKING ABOUT VALUES.





However, what I do want subscribers to realize is that the ESSENCE of Dow Theory is the concept of VALUES. "To know values," wrote Charles Dow, "is to know the meaning of the market." Those may be the most important words ever to come out of Wall Street. I want to emphasize this: Dow Theory uses the price movement to track the path of stocks, but it is STOCKS AS VALUES that the Theory is most concerned with.

It is also well to remember that primary bull and bear markets can take stocks to EXTREMES not normally seen. In a big bull market stocks have a tendency to advance BEYOND known values; in a big bear market stocks have a tendency to smash BELOW known values.

"All right," you counter, "but what constitutes a value?" I use three very fundamental concepts to measure value, and they all pertain to the Dow. Here they are. The first is YIELD or the return on investment. Historically, when the average yield on the Dow is 6.5% or more, the Dow stocks have attractive values. Historically, when the average yield on the Dow is 3.3% or less, it is overpriced. At present, the Dow is yielding 3.18%. On this basis, the Dow is overvalued.

The yield gauge is crucially important and historically absolutely valid. I have included the chart below to illustrate the yield concept. The chart traces the Dow and the Dow yield going back to 1947. The upper line delineates the 3% Dow yield zone. I have placed arrows at the actual spots where the Dow yield dropped to roughly 3%. Note that in each instance a 3% Dow yield gave way either to a major correction or (in the 1966 and 1973 instances) a bear market (chart courtesy of IQ Trends, 7440 Girard Ave., La Jolla, CA 92037).

Based on current Dow dividends of $67.04 (i.e., the combined dividends of the 30 Dow Industrials), the Dow would touch the 3% yield zone at a value of 2220 (which, amazingly, is exactly the level I projected for the Dow in my point & figure chart "count" -- see Letter 954).

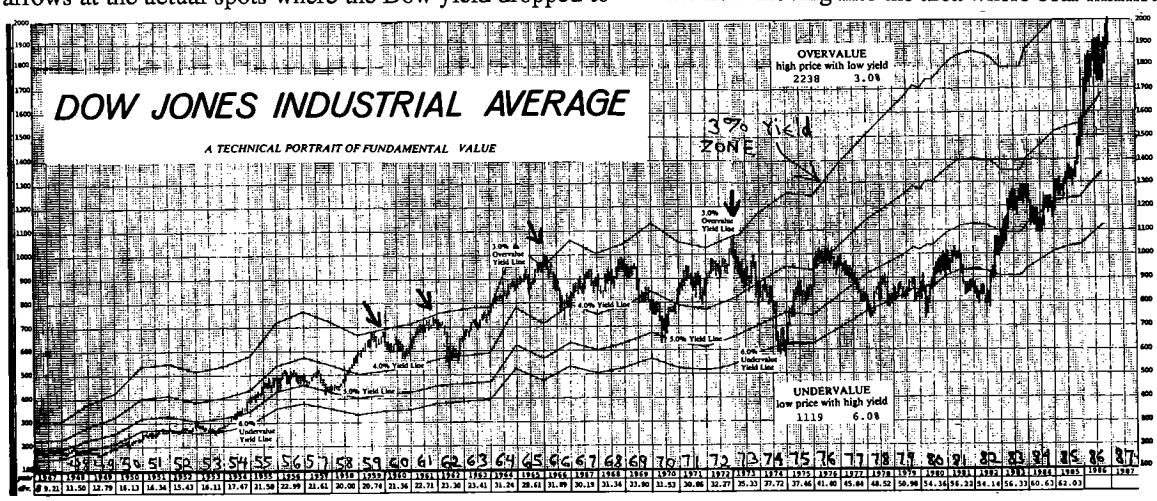
The second value measure that I use is BOOK VALUE. When the Dow is selling substantially below book value it is generally considered to be in the bargain area. When the Dow is substantially above its book value it can be considered overpriced. Since WW II the Dow has been below book value during only two periods -- 1973-74 and 1978-84. The book value for the Dow is now around 1000. With the Dow itself around 2100, the Dow is priced at roughly 110% above its book value. On this basis, the Dow is overvalued (Note: as recently as 1982 the Dow sold at 12% below book value).

The last test I use is the DOW P/E RATIO. Historically, when the Dow is selling below 10 times earnings it is in the bargain area. When the P/E for the Dow is above 17 the Dow is overpriced. In 1974 the Dow got down to 6 times earnings. During 1980 to 1982 the Dow sold at 7 to 9 times earnings. Those were extreme bargain areas. Value Line estimates 1986 earnings for the Dow at $118.40. If we accept the Value Line figure, the Dow is now selling at 17.7 times earnings. On this basis the Dow is overvalued. (Note, at the 1974 low the P/E for the Dow was 6.1; in 1979 it was 6.4; in 1981 it was 6.9).

One more study. I just spoke to Geraldine Weiss, publisher of Investment Quality Trends (see chart on page 4 of the last Letter). Gerrie told me that her percentage of undervalued blue-chip stocks is now down to a very low 14% (17% and below is considered the danger zone). In other words, only 14% of the 350 blue-chip issues that Gerrie monitors are now undervalued. Historically, when so few blue-chip stocks are undervalued, the entire stock market is on "thin ice."

The studies outlined above tell me that the Dow has entered the OVERPRICED area. From here on, the market will have to depend on excitement, speculation, and momentum to take it higher. On the basis of values, the great bull market has now done its job. It has taken stocks from the bargain zones of 1974, 1980, and '82 to the overvalued area of today.

The point I want to get across to readers is that from here on, we MUST be cautious. We must be cautious because the values in the investment grade stocks are no longer there. In three years we've gone from a green flag to a yellow flag and the yellow caution flag is currently beginning to show tinges of red around the edges. We are now moving into the area where bear markets are born.



QUESTION: Russell, in Letter 954 you discussed the Dow in terms of point & figure charting and you also discussed the P & F "count." In that Letter you showed that the Dow showed a count or P & F target of 2220. Do you still think that count will be reached by the Dow — or even surpassed?

ANSWER: When I wrote Letter 954 I hesitated to include that P & F section because the target of 2200 for the Dow seemed a bit far-fetched. But with the Dow up over 200 points since the first trading day of 1987 that 2220 target now seems a lot more reasonable.

Despite this market being overvalued (as outlined above), its sheer upside momentum could certainly take the Dow to the 2220 target. But in my own mind, I find myself wondering if such a surge might not lead to the big fooler for this bull market.

What kind of a fooler? The fooler might be that a continuing dramatic advance by the Dow to (or even a bit beyond) the 2220 area will produce a market that is GROSSLY OVERVALUED. At that point the trouble might begin. What kind of trouble? The kind of trouble I am thinking about is a major correction, or maybe even a primary bear market to start in the first half of 1987.

One final thought occurs to me here. Robert Rhea once wrote that "bear markets usually begin when the experts are placing the next bear market a year or so away." That statement is worth thinking about.

INVESTMENT POSITION: The bull remains in the box. The primary trend of the market is still definitely bullish. But read the following carefully. The big money, the investment money -- these are the people who SET THE TREND of the market. Investment money tends to deal in investment grade stocks, the kind of stocks that make up the Dow.

There's only one problem with today's market. The investment grade (Dow-type) stocks are becoming OVERVALUED. Once overvaluation occurs, then consciously or unconsciously, informed investors begin to DISTRIBUTE their wares. When this process carries far enough, a major top will have formed.

On this basis, if you have not bought stocks yet, my advice is -- don't jump in now. If you already have your equity position (and all my readers certainly should by now), sit tight -- don't buy any more. Regardless of what you hear from the "experts" and regardless of where this market goes on the upside, we are now moving into the distribution zone. The values today are THIN. The yields are minuscule, and individuals and funds and institutions are now buying out of greed or speculative excitement or fear of missing the move.

If you've owned a diversified list of the stocks recommended here over the last few years, you should now be showing fat profits. Let the profits run, and if you must do something, nail down a few of those profits. But I want my subscribers to understand this -- the great buying zone is now behind us. The values are just NOT there any more.

ANNOUNCEMENTS: For those who own our historical chart books of the D-J Averages and the advance-decline ratio, I want to announce that the 1986 pages are ready (and I must say that the 1986 pages portray the most fascinating price action in years). Price for the pages is $2 each, and please make the checks out to Richard Russell.

For newer subscribers who don't know what I'm talking about, I offer two loose-leaf, 3-ring binder chart books. One contains charts of the daily D-J Averages (Industrials, Transports, Utilities, Bonds, and volume) going all the way back to 1895 -- one page for each year. Major news events are shown on each page, and in this way you can see how the market reacted to the news events of the day.

The second album traces the daily path of the Dow and the A-D ratio going back to 1931, a page for each year. Divergences and non-confirmations are shown, and this album is a fascinating study in its own right.

These two large albums (pages are 11" x 17") are invaluable for serious students of the stock market (there is nothing else like them available). I probably refer to the albums three or four times each week in my own efforts to understand the market. Prices for the albums are $135 for the D-J Averages album and $95 for the A-D ratio album. please add 6% for California (we pay postage and shipping). No credit cards accepted on these; checks must be made out to Richard Russell.

SEMINAR: There's a GREAT investment seminar coming to the Century Plaza Hotel (Los Angeles) on March 11-15. I'll be speaking there along with such notables as Robert ("Dow 3600") Prechter, Al ("Low-key") Frank, Harry ("I found freedom") Browne, Paul ("End of the world") Erdman, Charles ("Discount Charlie") Schwab, Peter ("Cycle-man") Eliades, Stan ("The Man") Weinstein, Charles ("Mr. Cautious") Allmon, Mark ("They're watching us") Skousen, and many more. I mean, this is going to be quite a get-together! My good friends, Charlie and Kim Githler, are putting on the conference, and you can depend on them to DO IT UP RIGHT. For info call 813-955-0323 or write Investment Seminars, 1859 Main St., Sarasota, FL 33577.

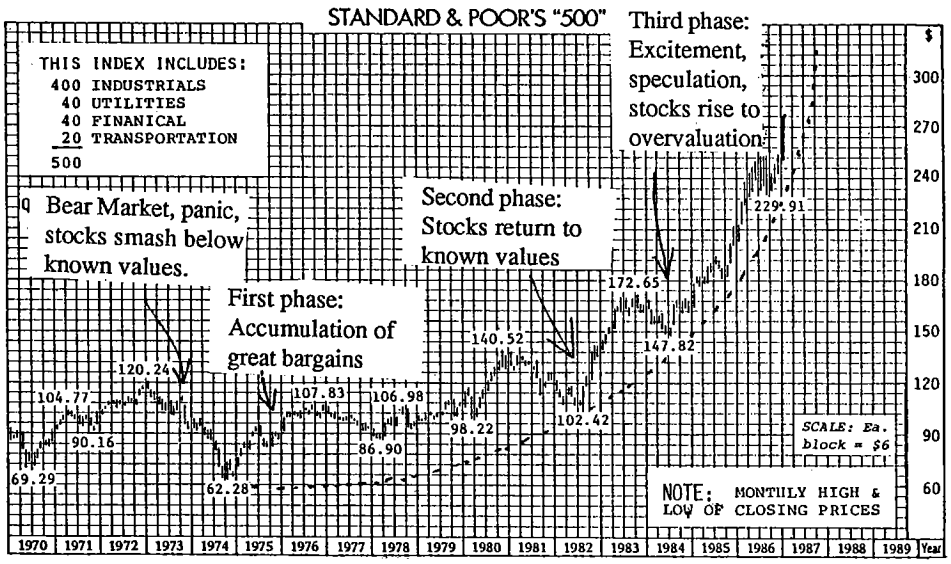
DOW THEORY AND THE MARKET: I think that at this time it is important that I discuss the market from the standpoint of the various PHASES as defined through Dow Theory. The reason I am writing this section now (a time of frenzied excitement) is that I want to provide some perspective. Perspective is what gives us the background to screw up our courage and buy at the lows of a bear market. Perspective is what gives us the guts to sell and then stay on the sidelines as a bull market roars towards its inevitable conclusion.

For the purposes of perspective, I am using this monthly Mansfield chart of the S&P 500, a chart that takes the 500 back to 1970. So let's review some history. A great bear market started in early 1973. By late-1974 the bear had smashed stocks in an extended period of downside violence unmatched since the 1930s. By the end of 1974 investors were beaten, terrified, and worn out. Speculators had largely exited the stock market. It was here (December '74) that I issued my "Special Report" in which I claimed that the great bear market was over. I published long lists of stocks to buy, stocks which I said were at fabulous bargain levels.

Happily, my call proved to be correct. The stock market surged up and continued up until 1976. This was the first phase of the new bull market. This phase finds stocks below known values, and it is here that informed investors accumulate. The first phase took place during 1975-76. From 1976 to 1978 a long, drawn-out correction occurred, but informed investors continued (correctly) to accumulate.

The second phase of the bull market began in 1978. It was here that stocks returned to known values and started moving up in earnest. During the second phase the public began nibbling on stocks, and it is clear that the public did this largely through mutual funds. The psychology then (and this is probably still true today) was, "I can't pick the winners, let the professionals do it." Thus during this period we witnessed a huge rise in mutual fund buying, with a conservative accent on income funds.

The second phase of the bull market ended at the 1983 highs. It was followed by a sizable correction to mid-1984. At this point, informed investors had their stock positions, the funds were advertising like mad for customers, and the public was getting its



"feet wet" in the market. But basically, the public was still skittish about equities.

The third phase of a bull market is the one which sees the public enter en masse. This is the final phase of any great bull market drama, and it is here that we finally see the excitement, the speculations, the newspaper headlines, the widespread interest from the public.

The third phase of the current bull market began at the 1984 bottom (1086 on the Dow), and the third phase is very much alive today. The public is in this market largely through mutual funds, and it is possible that the public (unlike the situation in previous bull markets) will pretty much stay with the funds. The entrance of the public into the current bull market will therefore be a matter of switching from income funds to equity funds (I have no doubt that this is what is occurring today).

I have connected the bottoms since 1974 with a rising curve (this was actually drawn with a French curve ruler). What we see here is an exponential rise in the S&P 500. An exponential rise is one in which the angle of ascent becomes steeper and steeper until finally the direction is vertical -- straight up. Of course, a vertical rise is not sustainable, so that, ultimately, an exponential rise results in a major top and usually a subsequent smash. The last historic example of this kind of action was seen in the 1979-80 rise in gold, a rise that ended with the entire gold and precious metal edifice toppling over into a vicious bear market.

We are now moving towards a top in the stock market. I feel that timing this top is near impossible. Stocks are currently overvalued, but they can obviously become more overvalued -- and they can STAY overvalued for months on end. However, I wanted my subscribers to see this chart and to understand that we are now in the third phase of the bull market. Moreover, we are nearing the vertical phase as far as the exponential curve (the angle of ascent) is concerned.

In other words, this is the area where informed investors start to distribute their stocks. And they have the best market in the world to distribute in -- a market that is going up, a market that is exciting, a market with huge upside volume. I believe that we might all start thinking in terms of distributing some of our own wares. As I said, timing the actual top of this bull market is going to prove well-nigh impossible.

NOTES & QUOTES: In 1987 32 foreign auto makers will be bringing in 134 different models for Americans to choose from. Joining the foreign invasion, Chevrolet will bring in five imported models including the $6,100 Suzuki-built Sprint (Chevy says it will get 58 miles on the highway in the ER Model). GM's foreigner, the $7,200 Pontiac Lemans will be built in S. Korea. Lincoln-Mercury will bring in its Tracer, which will be assembled in Mexico. Ford will bring in the Kia-built Korean mini-car called the Festiva.

Korea's Hyundai will be looking to sell 250,000 cars, up from an amazing 150,000 last year, which was the year of its introduction. The Rolls line goes from the "cheap" $106,000 Silver Spirit to the $168,000 Corniche convertible to the $198,000 limousine. Rolls sold 1,110 cars in the US in '85 and thinks it will maintain that pace. The Yugo GV at $3,990 is the lowest-priced car on the US market, but Yugo is coming out with their fancier GVX this year. Mercedes is entering '87 with 14 different models (the record for foreign makers) from the $26,400 190E 2.3 to the $68,000 560SEC. It should be quite a year for car dealers in the US (or at least a confusing one).

* *

The current system by which the federal government collects taxes is not only mind-bogglingly complicated -- it's very expensive. The Reagan administration now wants to increase the size of the IRS by 9,463 positions to 110,661 by 1989. If this is done, the total 1989 cost of the IRS will be $5.36 billion.

* *

The new W-4 withholding form is already bringing gasps of agony from taxpayers. The form is so complicated that Sen. Lloyd Bentsen (chairman of the Senate Finance Committee) wrote a letter to the IRS chief warning that "our goals will not be realized if workers are unable to decipher the form because of its complexity." Bentsen wanted to know if the IRS could "devise a simpler process." The IRS stated that it had no plans to change the form.

* *

The government and everyone else would save a fortune with a true flat tax of say 19% across the board for everyone with the exception of poverty cases. Imagine the savings to individuals and corporations if they could figure their taxes without lawyers, bookkeepers, accountants, etc. But of course, the true flat tax is a dream. Remember, most Congressmen are lawyers; they are part of the "tax industry." After all, what would Congress do if it couldn't spend most of each year messing up and messing around with the budget?

* *

While the US spends a fat 7% of its GNP on defense, Japan spends only 1% of GNP on defense. Japan today has only 245,000 men in its armed services (it had 5.3 million men in arms during WW II). Meanwhile, Russia has been beefing up its Far East forces and has 410,000 men there along
with the latest in high-tech missiles, tanks, and tactical nuclear weapons.

* *

Under the US anti-apartheid sanctions law there is a ban on S. African imports. But what about much-needed strategic metals? Oh, don't worry about them, the ban exempts 10 strategic metals from the ban (including natural industrial diamonds, chromium, manganese, platinum, vanadium, cobalt, etc) , and it also exempts five S. African companies from the ban.

* *

Sweden has become the ultimate socialist state. If you are a factory worker earning below $13,000, you get free prescription drugs, a subsidized apartment for $158 a month, a "study allowance" for your kids of $1,450 per child, day care for all children at $200 a month, five weeks of paid vacations, 60 days of sick leave a year at 90% of pay, free hospitalization, doctors call at $9 per visit, free university tuition (if your kids can pass the entrance tests), a pension at 2/3rds of your salary during your best years. To pay for all this Swedes have income taxes with all rates above 30%, a value-added tax of an unbelievable 23.5%, annual property taxes of 1.5% to 5%, corporate taxes of 52%. By the way, 40% of all Swedes work for the government.

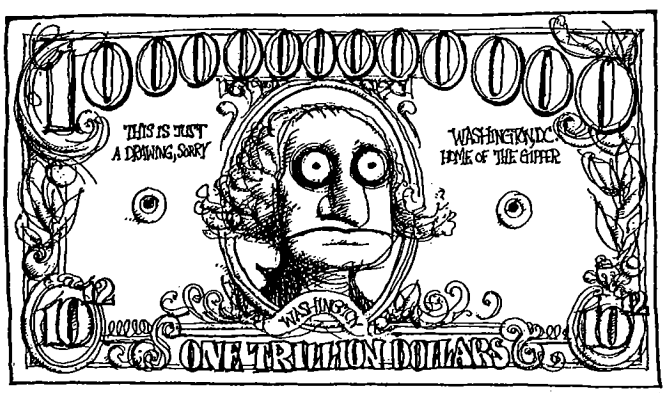
San Diego, tucked in the southwestern-most corner of the US, might yet become the sports center of the US (particularly in view of our incomparable weather). If Dennis Conner, sponsored by the San Diego Yacht Club, wins the America's Cup race, the next Cup race would probably be out of San Diego in 1990. On top of that, the next (1988) Super Bowl will be held in San Diego. Two years ago the San Diego Padres won the National League pennant. Who knows, maybe some day, somehow, maybe the San Diego Chargers will ... ah, dream on.

* *

Super Bowl: The way the NFL is presently set up, going to the Super Bowl COSTS the owners of the winning teams money (since all teams get the SAME TV money, going to the Super Bowl simply means more expenses for the owners of the two winning teams in terms of travel, extra game expenses, etc.). Now the NFL Players Assoc. wants to give the winning OWNERS a graduated $18 million extra on the way to the Super Bowl: $1.7 million for the wild-card winners, $2 million for division winners, $2.25 million to conference winners, $3.5 million for the Super-Bowl winner and $2.5 million for the Super-Bowl loser. Then the players want total free agency on the theory that with millions in extra incentives, the owners will have a much greater incentive to win, and consequently they will pay through the nose for the best players. Interesting idea -- good luck, you bruisers.

* *

With a new US currency in the works, I'm pleased to report that Dow Theory Letters has an exclusive on what the new currency is going to look like. Below is an exciting preview of the new money (yes, those are circles of pure fear in Washington's eyes).



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What's the world's biggest airline? It's Aeroflot, the domestic and international carrier of the Soviet Union. Aeroflot handles an eighth of the world's passenger traffic each year. It serves 3,600 Soviet cities and 122 cities in foreign countries. Aeroflot states that it has 1,500 fixed-wing aircraft (United, the West's biggest airline, has 300 to 350). No one knows what Aeroflot's safety record is; they seldom report accidents.

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There are currently 677,000 lawyers in the US or roughly one lawyer for every 354 people. That's far too many, and that's one reason why we read about all these thousands of lawsuits. A lot of these lawyers have nothing to do, so they run around looking for work, and a good deal of that work ends up in the courts.

So here's my advice to subscribers (particularly young subscribers) who are lawyers. If I were a lawyer I'd prepare right now for the future. And I think (seriously) that there's going to be a big future for lawyers who are experts in bankruptcy law. You may have to wait a few years before the time is fully ripe, but bankruptcy lawyers are going to have a picnic in the years ahead. Count on it.

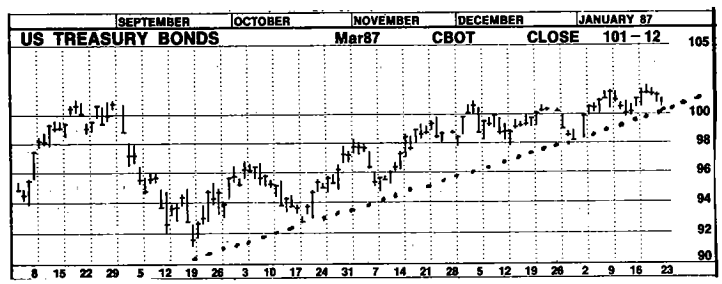
* *

This year's irony: Are you one of the people who takes the train because flying is "too dangerous?" Over the last two years deaths via commercial airlines in the U.S. are -- zero. Deaths by train are 15. Statistics, by the way, show that your chances of getting killed are greater on the trip to the airport than they are on the flight!

But all is not safe in America. The US murder rate is 10.2 per 10,000, highest in the industrialized world. The murder rate in a semi-war zone like Northern Ireland runs only 8.8 per 10,000. Detroit has a murder rate of 42.2 per 10,000.

* *

Question: Can bonds hold up in the face of an horrendous federal deficit and an equally sickening trade deficit and an accompanying weak dollar? They have so far, and it's been done with the help of low inflation rates and a Fed policy (with central bank cooperation) of lowering interest rates. So far, the Fed and the central banks have done the trick. They've kept rates low. And so far, the bond markets have liked it. Can it continue? Mmmmm? At any rate, I include this daily chart of the March T-bonds. They've been climbing the "up trendline" since late-September. At 99 the bonds will crack the trendline. At 97 I'd say that the bonds have reversed to the downside. It hasn't happened yet. So let's keep our fingers crossed.



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The acronym of the century belongs to Leno (Lee) IACOCCA. I-A-C-0-C-C-A = I Am Chairman of Chrysler Corporation Of America. At any rate, don't count on the chairman to run for US president in the next election. Here are Lee's latest views:

> DETROIT — The federal budget deficit probably will be neglected until after the 1988 election, predicted Chrysler Corp. Chairman Lee Iacocca, who also said he won't be campaigning to become the person to deal with it.
>
> The next president "is going to feel just like Herbert Hoover after the Jazz Age of Coolidge," Iacocca said in year-end interviews with news agencies. "He's going to bear the rap, and then they're going to throw (him) out. I'm not being a doomsday guy to say we've got pay the piper sometime."
>
> "Everybody's borrowing themselves silly. The nation's debt to total disposable income is at 19.5%. I learned a long time ago that if it's at 20 you're really in the danger zone, which is another way of saying consumer debt is going to require a pause. This recovery, fueled by Reaganomics, is into its 55th or 56th month . . . Does it never stop?"

WALL STREET NOTES: The first US sale of securities to the public occurred in 1861 when Jay Cook, heading a syndicate, offered $3 million in bonds for the Commonwealth of Pennsylvania. Cook sold the bonds via newspaper ads and persistent salesmen (in those days ALL common stocks were considered a rank gamble). ... E.F. Hutton in 1904 installed the first coast-to-coast wire service. ... Since 1850 Shearson Lehman has absorbed 43 assorted brokerage firms (this is a Wall Street record). ... In 1931 (near the depths of the Depression), E.A. Pierce had the largest number of individual brokers with a total of 204. Paine Webber had 106, Hutton had 92. Those, fellow readers, were tough times! ... During the Great Depression, Wall Street had what they termed "Scotch Weeks" in which brokers were paid three week's wages for four weeks of work. ... Total NYSE volume was 1.1 billion for the full year 1929; by 1942 volume for

the full year had plummeted to 126 million shares (I remember many 200,000-share days during 1947-49). Last week we had our first billion-share week -- quite a contrast. ... During the difficult days of 1969-70, 129 Wall Street firms merged or went belly up.

The first mutual fund was Mass. Investment Trust. MIT was originally established as an investment fund for Harvard. In 1924 MIT shares were first offered to the public. ... In 1908 Henry Ford introduced the Model T at a price of $850. Later the price came down to a low of $310. I remember seeing showroom prices for new Fords (in 1938) at $450. ... William Durant in 1908 started General Motors. Durant tried to buy Ford, but the deal fell through. Ford wanted $8 million for his company, and Durant wouldn't pay that much. Durant was the darling of Wall Street during the 1920s, but he later sold his GM stock. Durant was wiped out when he bought heavily in the big (upward) stock market correction of 1930. Later Durant retreated to New Jersey where he owned a diner (the once mighty industrialist was actually seen washing dishes in his kitchen). ... In 1911 the great Standard Oil Trust was broken up into five companies -- Standard Oil of NJ (now Exxon), California (Chevron), Ohio (now Standard Oil), Indiana, and New York (later called Socony and now called Mobil). ... In 1911 American Tobacco was broken up into American Tobacco, P. Lorrillard, Liggett & Myers, R.J. Reynolds and British-American Tobacco.

In 1916 the Dow pushed over the 100 mark for the first time. On Sept. 3, 1929 the Dow topped out at 381.17. It took 25 years for the Dow to better its 1929 high. I remember during the 1940s we were all convinced that the Dow would never again better the old '29 high. ... In 1924 Charles Watson left National Cash Register and started a new company called International Business Machines. ... In 1955 Jack Dreyfus bought the Nesbett Fund for $2.6 million and renamed it the Dreyfus Fund. Dreyfus then bought a huge chunk of an unlisted stock called Polaroid. That proved to be a brilliant investment. Dreyfus saw Polaroid stock go up 6,000%. ... On November 14, 1972 the Dow hurdled the 1000 barrier for the first time. ... In 1974 a NYSE seat sold for as low as $40,000. The price of a seat in 1986 went as high as $600,000 (moral: when Wall Street is at a bear market bottom, you don't have to buy the stocks, just buy a seat on the NYSE).

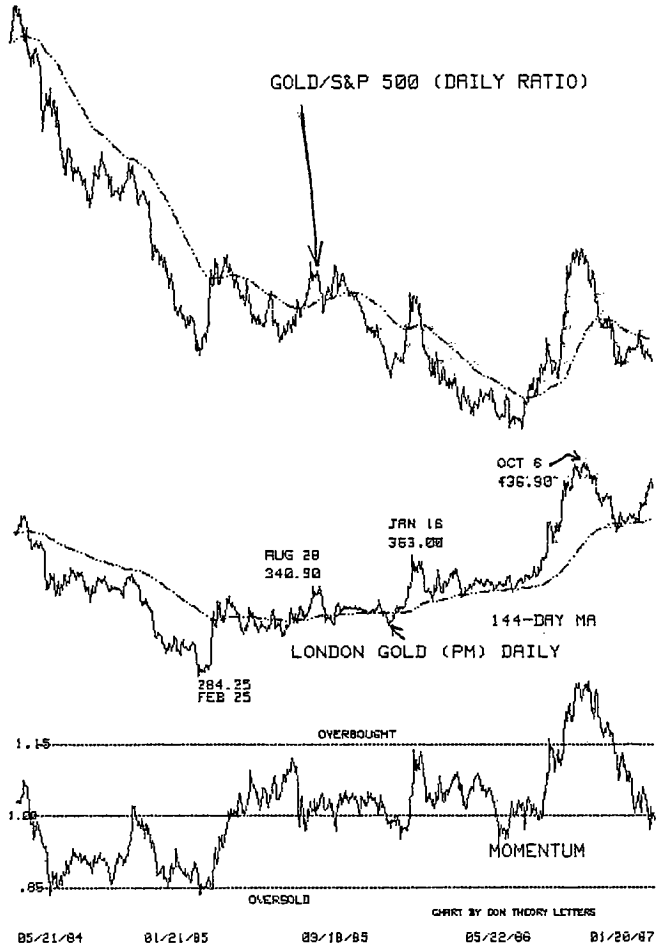
GOLD: I have said repeatedly that I believe gold is in the EARLY stages of a new bull market. My veteran subscribers remember the great exponential rising curve in gold of the late-1970s and into 1980. We remember gold climbing wildly, 20 points a day, 25 points a day, 35 points a day. Then came the spearpoint top of 850 in 1980 — and the crash. That crash told us that the precious metals market and the US inflation situation were over. A bear market in tangibles took over.

I stayed bearish on gold all during the early 1980s. Again and again I warned my subscribers (many of whom were gold–bugs) to forget gold, stay away from gold, do anything -- but don't buy gold. I kept up this chorus until early 1985.

In 1985 I reversed my stand. I stated that I believed a new gold bull market was in force. I am still of that opinion. But the early stages of any bull market are the difficult stages (remember the stock market during 1974-76?) Remember the shake–outs, the scares, the many ways in which the bull market tried to force us out? That's what's happening in gold now.

Let's examine an interesting chart that was churned out on our computer. The top line shows a ratio: the ratio is gold divided by the S&P 500. When this ratio is rising, gold is acting stronger than common stocks; when the ratio is falling common stocks are acting stronger than gold. Few people realize it, but this ratio hit its extreme low of 1.35 on July 2, 1986 - almost seven months ago. This is one of my criteria for a gold bull market (i.e., gold acting better than common stocks).

The middle line shows gold and its 144-day moving average (MA). The MA is now 392, and gold is holding above its MA. That's



positive. The lower line shows gold as a ratio of its own price 89 days ago. This is the momentum line. Gold momentum became very overbought last September-October, and you can see this clearly on this graph. Recently, gold momentum has dropped back to neutral.

Conclusion: Gold is still in a corrective phase. Last week gold tested the 400 level. It would be constructive for gold if it could hold ABOVE its MA. Continue the policy of buying equal dollar amounts of gold each month. I continue to consider gold at or below 400 to be in the accumulation zone.

LATE NOTES: On January 23 the Dow surged 68 points to touch an intra-day high of 2214.57; it then plunged 115 points to close at 2101.52 -- down 44.15 points for the day. At the intra-day high the Dow CAME WITHIN 5.47 POINTS of my point & figure projection of 2220. In closing down the Dow executed a one-day reversal on a record 302 million shares, the highest volume in history. What does it all mean? At this point, no one knows, but the violent, erratic action reminded me very much of the wild gold action during the historic run-up of 1980.

Every conceivable reason has been advanced for why this market "has to go up." Business will be better in '87 and '88, the world is floating in liquidity, the dollar is down and US stocks look dirt-cheap to foreigners, the public owns no common stocks, too many bears around, the funds are under-invested, American corporations are becoming lean and mean, the record short interest is unwinding, and so forth and so on.

My own feeling is that I don't want or need any explanations as to why the stock market has exploded. At this point in the game I prefer to look at the VALUE basis for the market. And as I have discussed at length in this Letter, the values are no longer there. As Charles H. Dow said, "To know values is to know the meaning of the market." With a 3.2% yield on the Dow, let the buyer (and speculator) beware.

NEXT MAILING: Feb. 11